



# Kansas Public Employees Retirement System

## **KPERS Overview**

*2011 KPERS Study Commission*

▪ *July 22, 2011*

# KPERS OVERVIEW

KPERS' mission is to provide retirement, disability and survivor benefits to our members and their beneficiaries.

Administer three statewide, defined benefit plans for public employees.

- Kansas Public Employees Retirement System
- Kansas Police & Firemen's Retirement System
- Kansas Retirement System for Judges

Partner with 1,499 state and local government employers.

- State of Kansas
- 293 school districts (update)
- 105 counties
- 474 cities & townships
- Other employers include libraries, hospitals, community colleges & conservation districts

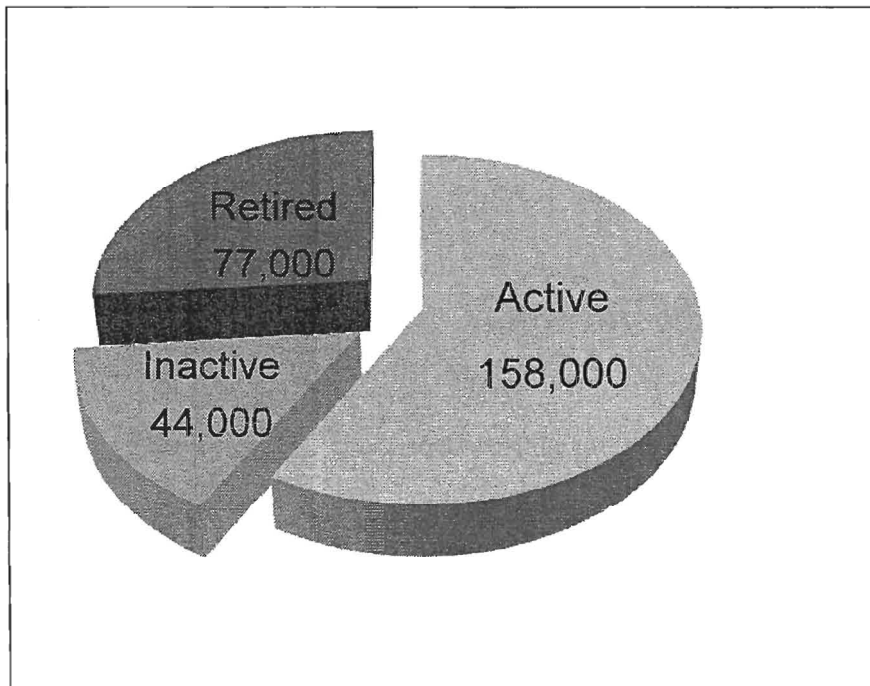
Governed by a nine-member Board of Trustees.

- 85-member staff.

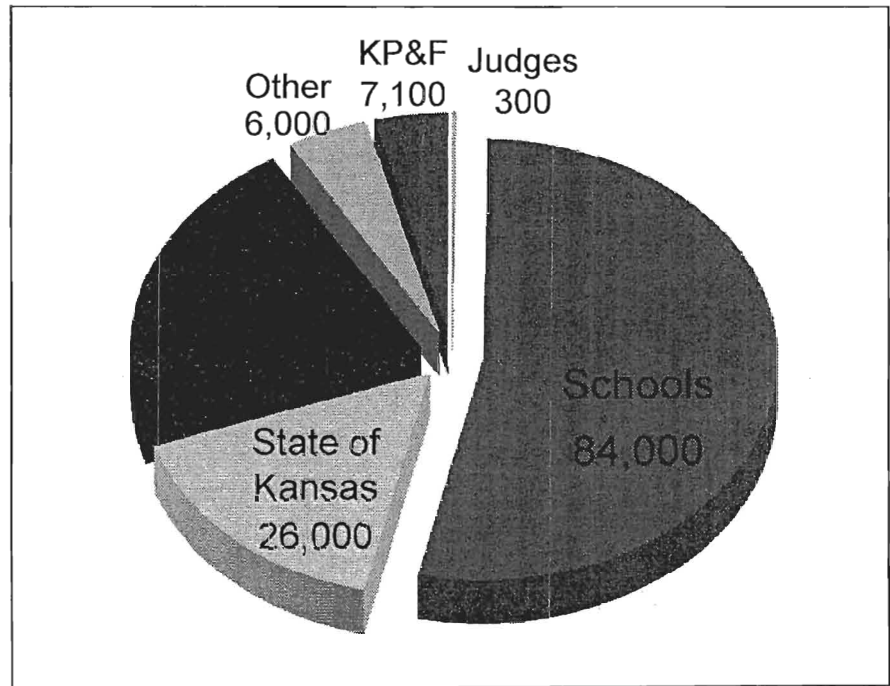
# Membership

- Serves 279,000 members.
- State of Kansas is largest participating employer.
- More than half of active members employed by school districts.

Total Membership



Active Membership



# Plan Basics

The Kansas Legislature enacts statutes defining benefits and how they are funded.

- membership eligibility
- employee and employer contributions
- service credit
- vesting
- benefit formula
- retirement eligibility

## Defined Benefit Formula

**Final Average Salary X Yrs. of Service X Multiplier = Annual Benefit**

*Typical Member\**: \$ 40,000 x 20 years x 1.75% = \$14,000

*Long-term Member*: \$ 40,000 x 30 years x 1.75% = \$21,000

- Benefits are a fixed monthly amount, paid for the remainder of the retiree's life.
- The average monthly benefit for KPERS retirees as of 12/31/10 was \$1,024.

\*Preliminary data of 12/31/10 shows that, for all new retirees from the System as a whole –

- The average final average salary was \$44,667.
- The average years of service was 21.9.

# Retirement Funding Formula

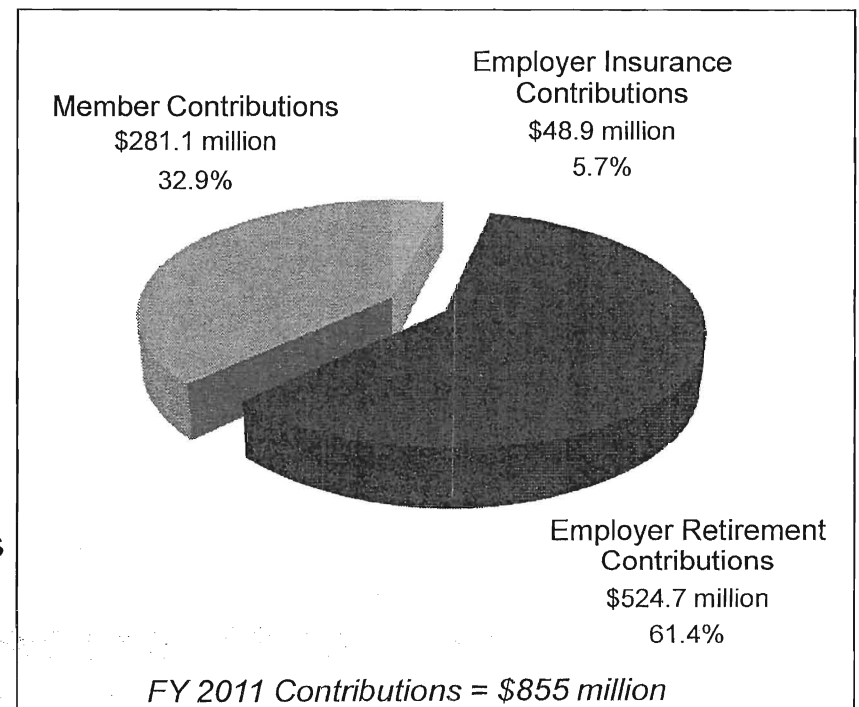
$$\text{Contributions} + \text{Investments} - \text{Expenses} = \text{Benefits}$$

## Contributions

- KPERS' total contributions for FY 2011 were over **\$855 million**.
- Employee Contributions\*
  - Tier 1 = 4% of pay
  - Tier 2 = 6% of pay
- Employer Contributions\*
  - Set by annual actuarial valuation as a percent of member payroll.
  - Cap on annual rate increase is set at 0.6% by statute.
  - The State pays employer contributions for state and school employees.

\* Does not reflect 2011 Sub HB 2194.

## FY 2011 Contributions



# Retirement Funding Formula (Continued)

## Investments

- Contributions are invested in a diversified portfolio to grow over time.
- Investment earnings make up the largest portion of assets available for benefits.
- KPERS has a long-term investment return assumption of 8%.

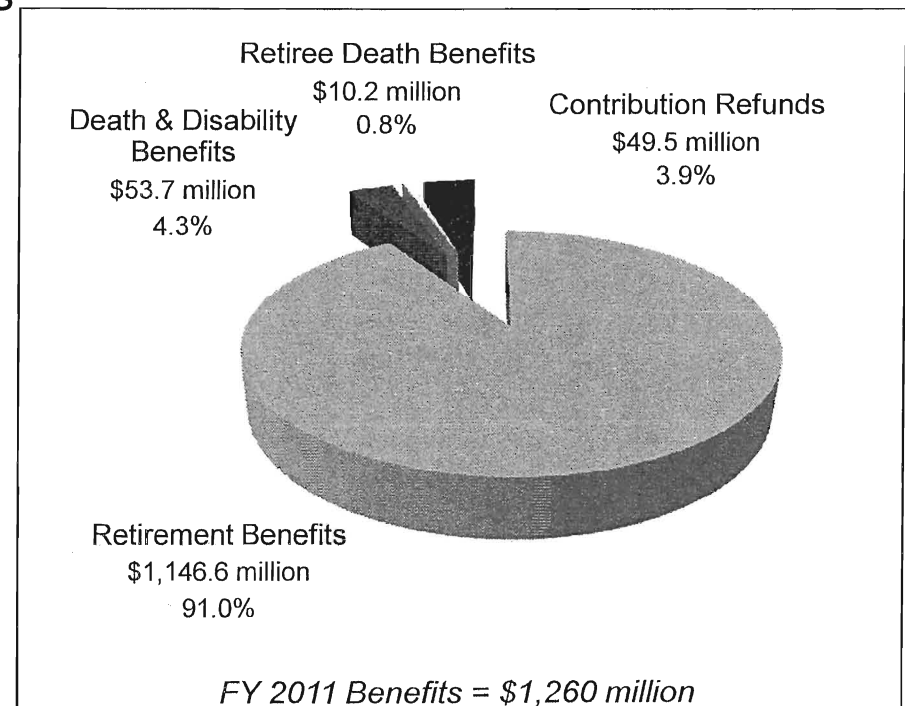
## Expenses

- FY 2011 investment management fees were 0.30% of total assets.
- FY 2011 benefit administration fees = 0.07% of total assets.

## Benefits

- KPERS' FY 2011 benefit payments were over **\$1.26 billion**.
  - Benefits are paid from the KPERS Retirement Trust Fund, which is required by the IRS to be used for the exclusive benefit of members.
  - Approximately 85% to 90% of benefits remain in Kansas.

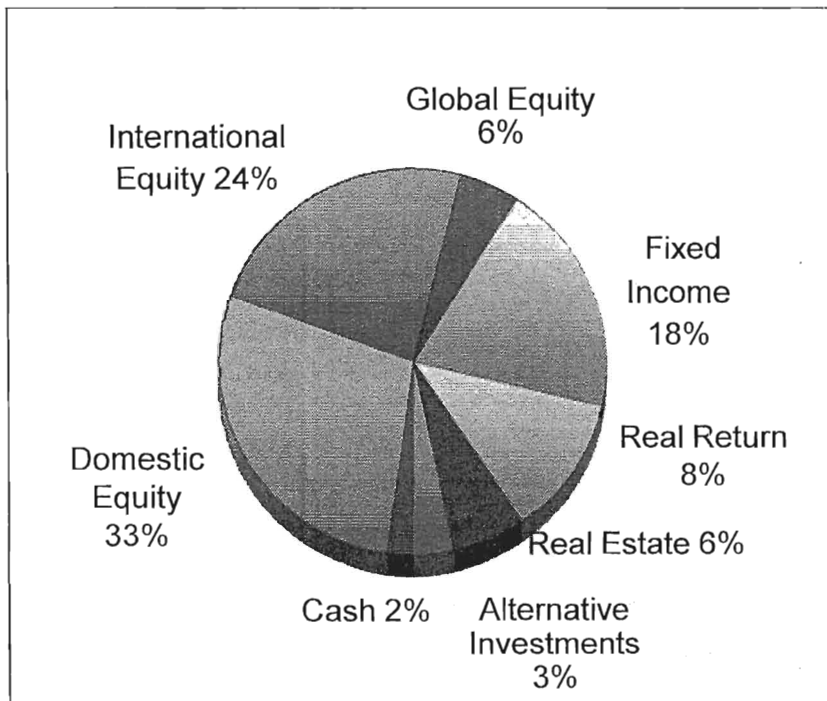
FY 2011 Benefits



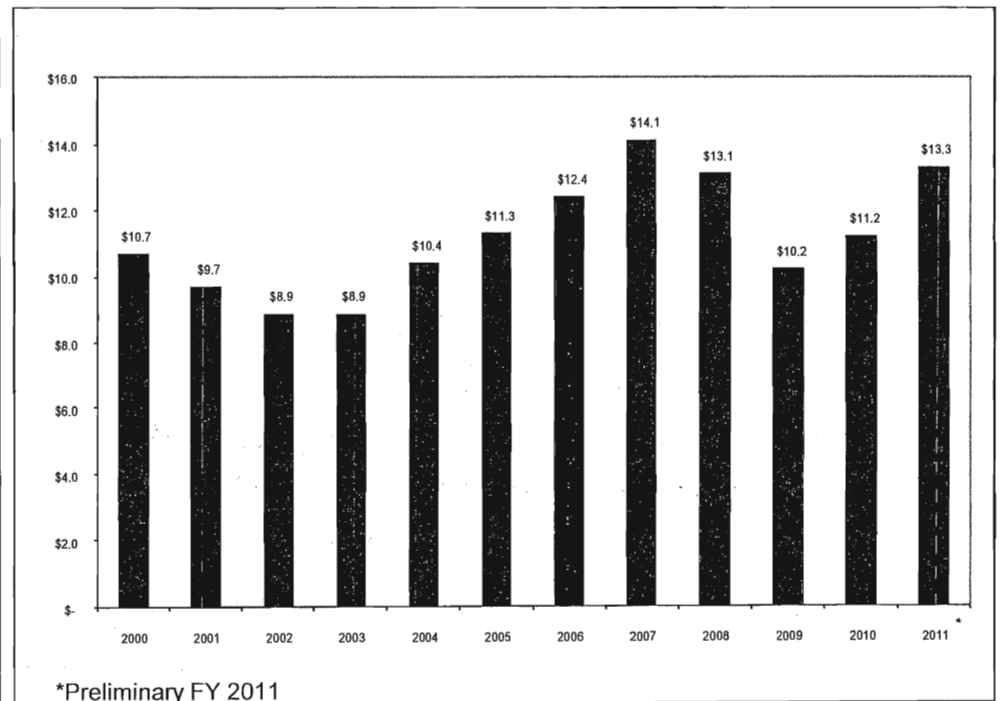
# Assets

KPERS manages the investment of \$13.3 billion in trust fund assets in the U.S. and international markets, with the assistance of external investment management firms.

*Current Asset Allocation*



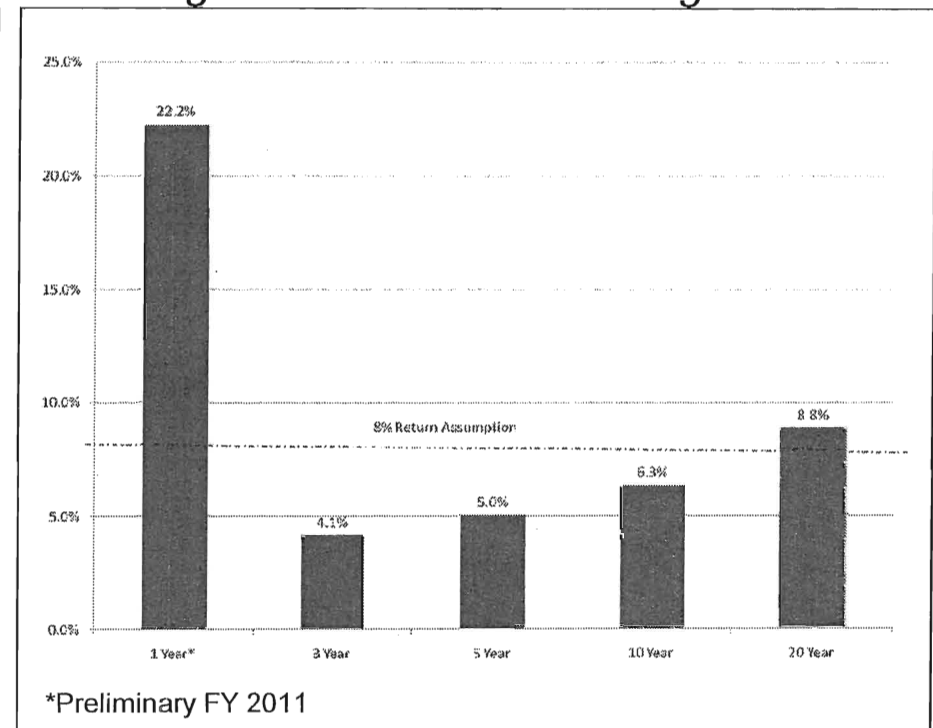
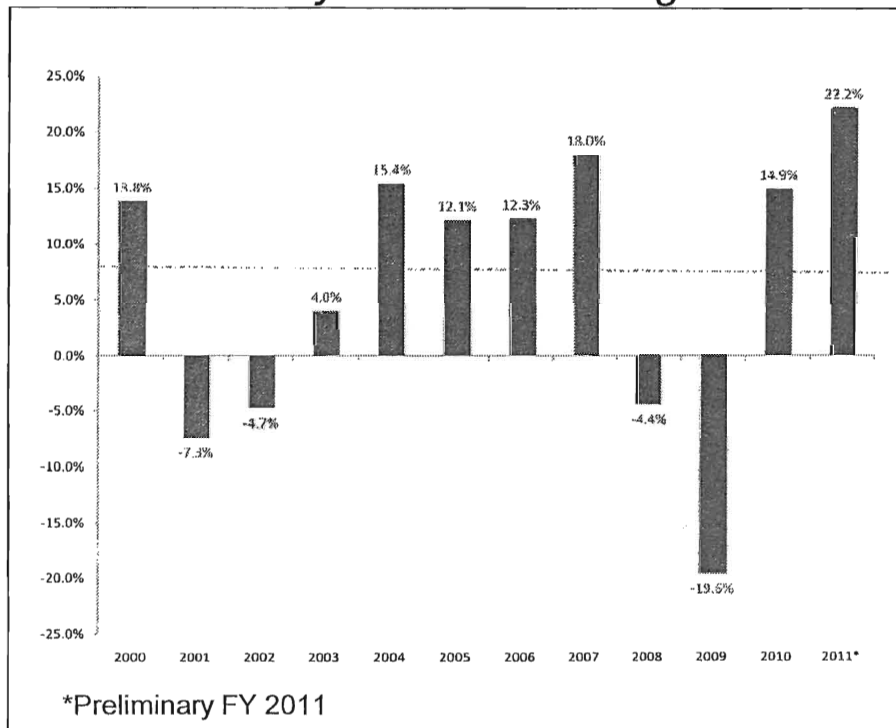
*Fund Growth FY 2000 – 6/30/2011 (in billions)*



# Investment Returns

- Although the past ten years have contained the four lowest fiscal year total returns (since 1976) for the System, the 20-year average annual return remains above the 8% actuarial assumption.
  - Fiscal YTD 2011 total return through May 31<sup>st</sup> was 23.5% for all assets.
  - Preliminary** estimate of total return for FY 2011 is 22.2%.

*Return History FY 2000 through 6/30/2011      Average Annual Return through 6/30/11*





# Funded Status

- KPERS' consulting actuary conducts an annual actuarial valuation of the System. The valuation is a snapshot view of KPERS' financial status at one point in time.
- Key measurements of a pension plan's funded status are:
  - **Unfunded Actuarial Liability (UAL)** – The UAL is the accrued actuarial liability for benefits minus the actuarial value of assets.
    - KPERS' UAL increased by \$3 billion in last five years to current \$8.3 billion.
  - **Funded Ratio** – The ratio of the actuarial value of assets to the accrued actuarial liabilities.
    - Funded ratio of 80% and rising generally considered adequate. Funded ratio of 60% or below considered at significant risk and requiring action to address.
    - KPERS' overall funded ratio has hovered around 60% the last three years, and School Group has been below 60% for several years.
  - **Actuarial Required Contribution Rate (ARC)** – Fundamental principle to contribute at the rate necessary to prefund benefits and payoff UAL over amortization period.
    - State and local governments have not contributed at ARC since FY 1996.
    - For FY 2012, the State/School statutory contribution rate is 62% of ARC.

# Historical Perspective on Long-Term Funding

- Over KPERS' 49-year history, the Legislature passed laws providing various benefit enhancements to KPERS members.
- The KPERS enhancements were common plan design features in most state defined benefit plans.
- A significant benefit enhancement package passed in 1993, which included:
  - Full retirement eligibility under the "85-point rule" (when the sum of a member's age and years of service credit equals 85) or at age 62 with 10 years of service.
  - An increase in the retirement formula factor from 1.4% to 1.75% for both previous and future service.
  - A 15% cost-of-living increase for retirees.
- To fund the enhancements, changes to actuarial methods were made, lowering employer contributions in initial years, but shifting the enhancements' costs into the future. In addition, an initial statutory cap of 0.1% was placed on annual increases to employer contribution rates.
- Although it did not become fully apparent for several years, these changes, along with subsequent experience losses and other factors adversely affecting liabilities, contributed to long-term funding issues that emerged in 2001-2002.

# Previous Actions to Address Funding Status

- By 2001 and 2002, actuarial projections indicated the KPERS retirement plan was not in actuarial balance.
- Following the 2001 actuarial valuation results, KPERS worked with the Legislature to develop a comprehensive, long-term funding plan to address the shortfall and bring the Plan into actuarial balance.
  - 2003 legislation raised statutory caps on employer contribution rate increases from 0.2% annually to 0.4% in FY 2006; 0.5% in FY 2007; and 0.6% in FY 2008 and subsequent years.
  - State issued \$500 million in pension obligation bonds in 2004. The debt service payments on these bonds, which are paid from the State General Fund, are approximately \$36 million annually.
  - 2007 legislation established a new plan design for employees hired on or after July 1, 2009, which increased retirement eligibility ages and employee contributions.
- These actions, along with strong investment returns in the 2004-2007 period, significantly improved the projected funding status of the System.

# Impact of 2008 Downturn on Funded Status

The unprecedented investment market declines in 2008 had a substantial negative impact on the funding status of the System, reversing forward progress on long-term funding.

- The 12/31/08 actuarial valuation report reflected:
  - A 12% decline in the System's funded ratio to 59%.
  - A \$2.7 billion increase in the unfunded actuarial liability (UAL) to \$8.3 billion.
- The actuarial value of assets were then significantly greater than their market value.
  - About \$2 billion in deferred losses were left to be averaged in over the next four years.
  - On a current market value basis, the funded ratio was 49%, and the UAL was \$10.3 billion.
- The School Group was out of actuarial balance.
  - This meant that, given the existing funding structure, the System would not have enough assets to provide all the benefits already earned by KPERS members and to pay off KPERS' UAL in the adopted amortization period ending in 2033.

# 2011 Legislative Responses

- Governor Brownback's 2011 State of the State address included KPERS as one of three key priorities with a major impact on the State budget.
- Both the Senate and House leadership created new legislative committees to address the unfunded liability and ensure the integrity and soundness of KPERS.
  - Senate Select Committee on KPERS.
  - House Committee on Pensions and Benefits.
- During the 2011 Session, these Legislative Committees discussed a range of options and held hearings on several bills related to KPERS' long-term funding.
- Each house passed a bill that included additional employer contributions and changes in contributions or benefits for current and future members.
- Elements of the bills from both chambers were agreed upon in a conference committee on Senate Substitute for HB 2194 (Sub HB 2194).
- The Conference Committee Report on Sub HB 2194 was approved by both chambers, and the bill was signed by the Governor.

# Sub HB 2194 Overview

- Sub HB 2194 provides for several changes to become effective if the 2012 Legislature acts on bills recommended by the KPERS Study Commission –
  - **Employer Contributions.** The statutory cap of 0.6 percent on State, School and Local employer contribution rates rises to 0.9% in FY 2014 and continues increasing 0.1% each subsequent year to 1.2% in FY 2017.
  - **Employee Changes.** Subject to approval of the IRS, members will be given the following one-time election options during a 90-day period starting July 2013:
    - **Tier 1 Members:** Contribution Increase or Benefit Decrease (future service)

6.0% contribution	1.85% multiplier (future service)	Default option
-OR-		
4.0% contribution	1.4% multiplier (future service)	

- **Tier 2 Members:** Benefit Decrease (future service only) or Lose COLA

6.0% contribution	1.75% multiplier & Lose COLA for all service	Default option
-OR-		
6.0% contribution	1.4% multiplier (future service) & Keep COLA	

# Key 2010 Valuation Results

- The 12/31/10 actuarial valuation shows an increase in the unfunded actuarial liability (UAL) of \$590 million to \$8.3 billion and a decrease in the funded ratio from 64% to 62%.
- The UAL will continue to increase and funded ratio decrease for several more years.
  - Deferred loss remaining from 2008 (\$672 million) will be recognized over next two years.
  - Statutory employer rates significantly below actuarially required rates (ARC) for School and Local Groups.
  - Amortization payment methodology results in UAL increases for several more years.
- Key valuation highlights
  - School group with 55% funded ratio is of the most concern.
  - Without Sub HB 2194, the State/School Group is projected to reach ARC in FY 2031 at 20.02%
  - With Sub HB 2194, the State/School Group is projected to reach ARC in FY 2018 at 14.46%.

# Key 12/31/10 Valuation Measurements

Group	Contribution Rates*		Actuarial Funded Status	
	Actuarial Rate	Statutory Rate	Unfunded Actuarial Liability (in Millions)	Funded Ratio
State	9.82%	9.97%	\$932	76%
School	15.12%	9.97%	\$5,313	55%
Local	9.43%	7.94%	\$1,395	63%
KP&F	17.26%	17.26%	\$598	74%
Judges	23.62%	23.62%	\$27	83%
System Totals			\$8,264	62%

\*Effective for fiscal year beginning in 2013. (FY 2014 for State and School Groups, State KP&F employers, and Judges. CY 2013 for Local Group and Local KP&F employers.)



# KPERS Board Actions

- As a first step toward implementation of Sub HB 2194, KPERS submitted a request to the IRS for a letter ruling as to the permissibility of offering members the contribution-benefit elections.
- KPERS recently completed two triennial studies that relate to long-term funding issues – an asset-liability study and an experience study.
- The asset-liability study develops an appropriate asset mix to fund the liabilities.
  - The asset mix is based upon assumptions regarding future expected rates of return and risks posed by various asset classes, as well as KPERS' ability to invest in them.
  - The new asset mix adopted by the Board involves incremental changes.

	Current Actual Allocation	Long-Term Target Policy
U.S. Equity	36%	30%
Non-US Equity	27%	29%
Fixed Income	18%	15%
Real Return	8%	8%
KPERS Real Estate	6%	12%
Alternatives	3%	5%
Cash	2%	1%

# KPERS Board Actions (Continued)

- The experience study evaluates the System's actual experience as compared to its demographic and economic actuarial assumptions.
  - The Board establishes new or revised actuarial assumptions using the findings of the experience study.
  - At the conclusion of this experience study, the Board adopted a small number of technical changes to demographic assumptions.
- The investment return is a key economic actuarial assumption.
  - Because benefits paid by a pension system are accrued and paid out over many decades, the investment return assumption reflects a very long-term investment perspective of 30 years.
  - KPERS has used an 8% assumption since 1986 and has realized an 8.5% average return for those 25 years.
  - After careful study and deliberation, the Board decided to retain the System's 8% actuarial return assumption and revisit the issue again next year.

# Conclusion

- Despite strong investment returns the past two years, the 12/31/10 actuarial valuation shows a modest funding decline and that the long-term funding shortfall will continue to grow in the near term.
- The additional employer and employee contributions and plan design changes included in Sub HB 2194 are a meaningful step towards improving the System's long-term funding outlook and reaching actuarially required contribution levels.
- The impact of these additional contributions in improving the funded ratio and other measures of the funded status will be limited in the next 10 years. Consequently, the System is vulnerable to future economic downturns that cause investment returns to decline.
- The KPERS Board and staff look forward to supporting the work of the KPERS Study Commission to review alternatives and develop a viable plan for consideration by the Legislature to ensure the long-term sustainability of KPERS benefits for its members.